

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

[Third Party Communication:

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B02

PLR-140387-08

Date:

January 08, 2009

Legend:

Distributing =

Controlled 1 =

Controlled 2 =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

Shareholder H =

Shareholder I =

Shareholder J =

Shareholder K =

Shareholder L =

Shareholder M =

Shareholder N =

Shareholder 0 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

State A =

Date B =

Business C =

Dear :

This is in response to a letter dated September 2, 2008 requesting rulings as to the Federal income tax consequences of a series of proposed transactions (collectively, the "Proposed Transactions"). The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding whether any of the distributions described below: (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal

Revenue Code and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50% or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

Distributing is a State A S corporation that files a Federal income tax return using the cash method and a fiscal year ending Date B. Distributing is engaged in Business C.

Distributing has a shares of stock outstanding. Shareholder D owns approximately b% of the shares; Shareholder E owns approximately c%; Shareholder F owns approximately d%; Shareholder G owns approximately b%; Shareholder H owns approximately e%; Shareholder I owns approximately e%; Shareholder J owns approximately d%; Shareholder K owns approximately d%; Shareholder L owns approximately f%; and each of Shareholder M, Shareholder N, and Shareholder O owns approximately g%. Shareholder E, Shareholder M, Shareholder N, and Shareholder O are trusts and the other shareholders are individuals.

Within the last five years, Distributing has engaged in h exchanges (the “Prior Transactions”) represented to qualify under section 1031. In each case, property used by Distributing in the conduct of Business C before the exchange was exchanged for other property used by Distributing in the conduct of Business C after the exchange.

For what are represented to be valid business purposes, the following series of transactions is proposed:

- (i) Distributing will form two wholly-owned subsidiary corporations, Controlled 1 and Controlled 2.
- (ii) Distributing will contribute certain assets (constituting approximately i% of the fair market value of Distributing’s assets immediately before the Proposed Transactions) to Controlled 1 in exchange for all of the stock of Controlled 1 and the assumption of certain liabilities (the “Controlled 1 Contribution”).
- (iii) Distributing will contribute certain assets (constituting approximately i% of the fair market value of Distributing’s assets immediately before the Proposed Transactions) to Controlled 2 in exchange for all of the stock of Controlled 2 and the assumption of certain liabilities (the “Controlled 2 Contribution”).
- (iv) Distributing will distribute all of the stock of Controlled 1 to Shareholder D, Shareholder G, Shareholder M, Shareholder N, and Shareholder O

(collectively, the “Group 1 Shareholders”) in exchange for all of their Distributing stock (the “Controlled 1 Distribution”).

- (v) Distributing will distribute all of the stock of Controlled 2 to Shareholder E, Shareholder H, and Shareholder I (collectively, the “Group 2 Shareholders”) in exchange for all of their Distributing stock (the “Controlled 2 Distribution”).

Distributing has made the following representations in connection with the Controlled 1 Contribution and the Controlled 1 Distribution:

- (a) The fair market value of the Controlled 1 stock and the other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholders in the exchange.
- (b) No part of the consideration to be distributed by Distributing in the Controlled 1 Distribution will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation’s present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled 1 will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled 1 is carried out for the following corporate business purpose: to enhance the success of the business by enabling the business to resolve management, systemic, and other problems that have been exacerbated by the taxpayer’s operation of its active business within a single corporation. The distribution of the stock, or stock and securities, of Controlled 1 is motivated, in whole or substantial part, by this corporate business purpose.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled 1 or both.
- (g) For purposes of section 355(d), immediately after the Controlled 1 Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50% or more of the total combined voting power of

all classes of Controlled 1 stock entitled to vote, or 50% or more of the total value of shares of all classes of Controlled 1 stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Controlled 1 Distribution, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6) ending on the date of the Controlled 1 Distribution.

- (h) For purposes of section 355(d), immediately after the Controlled 1 Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50% or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50% or more of the total value of all shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)), during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Controlled 1 Distribution.
- (i) The total adjusted bases of the assets to be transferred to Controlled 1 by Distributing in the transaction will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled 1 and (ii) the total amount of any money and the fair market value of any property (within the meaning of section 361(b)) received by Distributing from Controlled 1 and transferred to the shareholders or the creditors of Distributing pursuant to the plan of reorganization.
- (j) The total fair market value of the assets transferred to Controlled 1 in the transaction will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled 1 in the exchange, (ii) the amount of any liabilities owed to Controlled 1 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in the exchange. The fair market value of the assets of Controlled 1 will exceed the amount of its liabilities immediately after the exchange.
- (k) The liabilities assumed by Controlled 1 in the Controlled 1 Contribution and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Controlled 1 Distribution.

- (m) No intercorporate debt will exist between Distributing and Controlled 1 at the time of, or subsequent to, the Controlled 1 Distribution.
- (n) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 1 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No two parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (p) The Controlled 1 Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50% or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled 1 (including any predecessor or successor of such corporation).
- (q) No person will hold a 50% or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or the stock of Controlled 1 immediately after the Controlled 1 Distribution who did not hold such an interest immediately before the Controlled 1 Distribution.

Distributing has made the following representations in connection with the Controlled 2 Contribution and the Controlled 2 Distribution:

- (r) The fair market value of the Controlled 2 stock and the other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholders in the exchange.
- (s) No part of the consideration to be distributed by Distributing in the Controlled 2 Distribution will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder.
- (t) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (u) Following the transaction, Distributing and Controlled 2 will each continue, independently and with its separate employees, the active conduct of its

share of all the integrated activities of the business conducted by Distributing prior to the consummation of the transaction.

- (v) The distribution of the stock of Controlled 2 is carried out for the following corporate business purpose: to enhance the success of the business by enabling the business to resolve management, systemic, and other problems that have been exacerbated by the taxpayer's operation of its active business within a single corporation. The distribution of the stock, or stock and securities, of Controlled 2 is motivated, in whole or substantial part, by this corporate business purpose.
- (w) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled 2 or both.
- (x) For purposes of section 355(d), immediately after the Controlled 2 Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50% or more of the total combined voting power of all classes of Controlled 2 stock entitled to vote, or 50% or more of the total value of shares of all classes of Controlled 2 stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6) ending on the date of the Controlled 2 Distribution.
- (y) For purposes of section 355(d), immediately after the Controlled 2 Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50% or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50% or more of the total value of all shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)), during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Controlled 2 Distribution.
- (z) The total adjusted bases of the assets to be transferred to Controlled 2 by Distributing in the transaction will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled 2 and (ii) the total amount of any money and the fair market value of any property (within the meaning of section 361(b)) received by Distributing from Controlled 2 and transferred to the shareholders or the creditors of Distributing pursuant to the plan of reorganization.

- (aa) The total fair market value of the assets transferred to Controlled 2 in the transaction will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled 2 in the exchange, (ii) the amount of any liabilities owed to Controlled 2 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in the exchange. The fair market value of the assets of Controlled 2 will exceed the amount of its liabilities immediately after the exchange.
- (bb) The liabilities assumed by Controlled 2 in the Controlled 2 Contribution and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (cc) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Controlled 2 Distribution.
- (dd) No intercorporate debt will exist between Distributing and Controlled 2 at the time of, or subsequent to, the Controlled 2 Distribution.
- (ee) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (ff) No two parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (gg) The Controlled 2 Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50% or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled 2 (including any predecessor or successor of such corporation).
- (hh) No person will hold a 50% or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or the stock of Controlled 2 immediately after the Controlled 2 Distribution who did not hold such an interest immediately before the Controlled 2 Distribution.

Section 1361(a)(1) defines an “S corporation,” with respect to any taxable year, as a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust, described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of the cessation. Section 1362(d)(2)(B).

Based solely on the information submitted and the representations made, we rule as follows with respect to the Controlled 1 Contribution and the Controlled 1 Distribution:

- (1) The Controlled 1 Contribution and the Controlled 1 Distribution, taken together, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled 1 each will be “a party to a reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing on the Controlled 1 Contribution. Sections 361(a) and 357(a).
- (3) No gain or loss will be recognized by Controlled 1 on the Controlled 1 Contribution. Section 1032(a).
- (4) Controlled 1’s basis in each asset received from Distributing in the Controlled 1 Contribution will equal the basis of that asset in the hands of Distributing immediately before the Controlled 1 Contribution. Section 362(b).
- (5) Controlled 1’s holding period for each asset received from Distributing in the Controlled 1 Contribution will include the holding period during which Distributing held that asset. Section 1223(2).
- (6) No gain or loss will be recognized by Distributing upon the Controlled 1 Distribution. Section 361(c).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Group 1 Shareholders upon the receipt of Controlled 1 stock in the Controlled 1 Distribution. Section 355(a)(1).

- (8) The basis of the Controlled 1 stock in the hands of the Group 1 Shareholders will, in each instance, be the same as the basis of the respective Distributing 1 stock surrendered therefor. Section 358(a)(1).
- (9) The holding period of the Controlled 1 stock received by the Group 1 Shareholders in the Controlled 1 Distribution will, in each instance, include the holding period of the respective Distributing stock surrendered in exchange therefor, provided that such Distributing stock was held as a capital asset on the date of the Controlled 1 Distribution. Section 1223(1).
- (10) Proper allocation of Distributing's earnings and profits will be made under section 312(h) and Treas. Reg. § 1.312-10(a).
- (11) Distributing's momentary ownership of the stock of Controlled 1, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled 1 to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled 1 otherwise meets the requirements of section 1361(b)(1), it will be eligible to make an election under section 1362(a) to be treated as a subchapter S corporation for its first taxable year, provided such election is made effective immediately after the distribution of the stock of the corporation.

Based solely on the information submitted and the representations made, we rule as follows with respect to the Controlled 2 Contribution and the Controlled 2 Distribution:

- (12) The Controlled 2 Contribution and the Controlled 2 Distribution, taken together, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled 2 each will be "a party to a reorganization" within the meaning of section 368(b).
- (13) No gain or loss will be recognized by Distributing on the Controlled 2 Contribution. Sections 361(a) and 357(a).
- (14) No gain or loss will be recognized by Controlled 2 on the Controlled 2 Contribution. Section 1032(a).
- (15) Controlled 2's basis in each asset received from Distributing in the Controlled 2 Contribution will equal the basis of that asset in the hands of Distributing immediately before the Controlled 2 Contribution. Section 362(b).
- (16) Controlled 2's holding period for each asset received from Distributing in the Controlled 2 Contribution will include the holding period during which Distributing held that asset. Section 1223(2).

- (17) No gain or loss will be recognized by Distributing upon the Controlled 2 Distribution. Section 361(c).
- (18) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Group 2 Shareholders upon the receipt of Controlled 2 stock in the Controlled 2 Distribution. Section 355(a)(1).
- (19) The basis of the Controlled 2 stock in the hands of the Group 2 Shareholders will, in each instance, be the same as the basis of the respective Distributing stock surrendered therefor. Section 358(a)(1).
- (20) The holding period of the Controlled 2 stock received by the Group 2 Shareholders in the Controlled 2 Distribution will, in each instance, include the holding period of the respective Distributing stock surrendered in exchange therefor, provided that such Distributing stock was held as a capital asset on the date of the Controlled 2 Distribution. Section 1223(1).
- (21) Proper allocation of Distributing's earnings and profits will be made under section 312(h) and Treas. Reg. § 1.312-10(a).
- (22) Distributing's momentary ownership of the stock of Controlled 2, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled 2 to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled 2 otherwise meets the requirements of section 1361(b)(1), it will be eligible to make an election under section 1362(a) to be treated as a subchapter S corporation for its first taxable year, provided such election is made effective immediately after the distribution of the stock of the corporation.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to:

- (i) Whether either Distribution 1 or Distribution 2 satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);

- (ii) Whether either Distribution 1 or Distribution 2 is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d));
- (iii) Whether either Distribution 1 or Distribution 2 is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50% or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7);
- (iv) The application of section 1031 to any of the Prior Transactions described above; and
- (v) Whether Distributing is a valid subchapter S corporation, or whether either of Controlled 1 or Controlled 2 is otherwise eligible to be a subchapter S corporation.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Sean P. Duffley
Senior Counsel, Branch 2
Office of Associate Chief Counsel (Corporate)

cc: